FINANCIAL SERVICES INSTITUTE

VOICE OF INDEPENDENT FINANCIAL SERVICES FIRMS AND INDEPENDENT FINANCIAL ADVISORS

VIA ELECTRONIC MAIL

September 6, 2022

Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549

Re: SR-FINRA-2022-024: Notice of Filing of a Proposed Rule Change to Amend the Codes of Arbitration Procedure to Modify the Current Process Relating to the Expungement of Customer Dispute Information

Dear Secretary:

Previously, in 2017, the Financial Industry Regulatory Authority, Inc. (FINRA) published its request for public comment on proposed amendments to FINRA's rules governing expungement of customer related dispute information.[1] The 2017 proposal made substantive changes to the expungement process,[2] and were part of a series of changes FINRA was considering at the time and continues to consider today. [3] The proposal was ultimately withdrawn by FINRA in May of 2021[4] and are now being reproposed and filed with the SEC after FINRA made additional changes in response to input from various stakeholders (Proposed Amendments or Proposed Rule)[5]

As stated in the Notice, "FINRA believes the proposed amendments…are responsive to the concerns that have been identified with the current expungement process." Indeed, FSI appreciates several of the changes FINRA made from the 2017 proposal to the current Proposed Amendments, including the two year allowable time for straight-in expungement requests.

The Financial Services Institute[6] (FSI) appreciates the opportunity to comment on this important proposal that has now been filed with the SEC. FSI has supported, and continues to

[1] *See, generally,* Regulatory Notice 17-42 (December 6, 2017).
[2] *See, generally, Id.*
[3] *Id.* at p.1 and FINRA Discussion Paper on Expungement of Customer Dispute Information (April 2022) available at https://www.finra.org/sites/default/files/2022-04/Expungement_Discussion_Paper.pdf.
[4] See FINRA Statement on Temporary Withdrawal of Specialized Arbitrator Roster Rule Filing (May 28, 2021), https://www.finra.org/media-center/newsreleases/2021/finrastatement-temporary-withdrawal-specialized-arbitrator-roster.
[5] Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of a Proposed Rule Change To Amend the Codes of Arbitration Procedure To Modify the Current Process Relating to the Expungement of Customer Dispute Information (Notice) available at https://www.federalregister.gov/documents/2022/08/15/2022-17430/self-regulatory-organizations-financial-industry-regulatory-authority-inc-notice-of-filing-of-a.
[6] The Financial Services Institute (FSI) is an advocacy association comprised of members from the independent financial services industry, and is the only organization advocating solely on behalf of independent financial advisors and independent financial services firms. Since 2004, through advocacy, education and public awareness, FSI has

support, restrictions on financial advisors' ability to expunge certain information from the Central Registration Depository (CRD) and, consequently, from FINRA's BrokerCheck system. As we stated in our previous comments, the absence of such restrictions would pose a risk to investors because, among other things, it would make it easier for high-risk or recidivist brokers to move through the industry undetected. It would also impede regulators' ability to execute their oversight responsibilities and deny investors access to important information.

FSI supports reasonable, unambiguous restrictions on the expungement of truthful, accurate information that is crucial for investor protection, but to be effective, it must also provide an avenue to remove information that is misleading, meaningless or has no regulatory or investor protection value. Additionally, FSI believes that various financial industry regulators would benefit from coordination to permanently ban bad actors from having access to investors. This proposal appears to be an important step forward in such coordination. However, we urge the SEC to consider certain aspects of the proposal to ensure such coordination is indeed impactful and the Proposed Amendments do not negatively impact the ability of financial advisors to seek expungement where appropriate.

Background on FSI Members

FSI is an advocacy association comprised of members from the independent financial services industry. The independent financial services community has been an important and active part of the lives of American investors for more than 40 years. In the US, there are more than 160,000 independent financial advisors, which account for approximately 52 percent of all producing registered representatives.[7] These financial advisors are self-employed independent contractors, rather than employees of the Independent Broker-Dealers (IBD).[8] FSI's IBD member firms provide business support to independent financial advisors in addition to supervising their business practices and arranging for the execution and clearing of customer transactions.

FSI members make substantial contributions to our nation's economy. According to Oxford Economics, FSI members nationwide generate $35.7 billion in economic activity. This activity, in turn, supports 408,743 jobs including direct employees, those employed in the FSI supply chain, and those supported in the broader economy. In addition, FSI members contribute nearly $7.2 billion annually to federal, state, and local government taxes.[9]

Independent financial advisors are small-business owners and job creators with strong ties to their communities. These financial advisors provide comprehensive and affordable financial services that help millions of individuals, families, small businesses, associations, organizations, and retirement plans. Their services include financial education, planning, implementation, and investment monitoring. Due to their unique business model, FSI members and their affiliated financial advisors are especially well positioned to provide Main Street Americans with the affordable financial advice, products, and services necessary to achieve their investment goals.

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been working to create a healthier regulatory environment for these members so they can provide affordable, objective financial advice to hard-working Main Street Americans.

[7] Cerulli Associates, Advisor Headcount 2016, on file with author.

[8] The use of the term "financial advisor" or "advisor" in this letter is a reference to an individual who is a dually registered representative of a broker-dealer and an investment adviser representative of a registered investment adviser firm. The use of the term "investment adviser" or "adviser" in this letter is a reference to a firm or individual registered with the Securities and Exchange Commission (SEC) or state securities division as an investment adviser.

[9] Oxford Economics for the Financial Services Institute, The Economic Impact of FSI's Members (2020).

Discussion

As stated above, FSI supports reasonable restrictions on financial advisors' ability to expunge customer dispute information from CRD. To that end, FSI is concerned that participants on the Special Arbitrator Roster are not required to have securities industry experience and, thus, may fail to appreciate the factual nuances that gave rise to the customer's allegations against the advisor. This is particularly concerning given that the Proposed Amendments will require a unanimous decision in order to grant expungement. Additionally, we are concerned about impractical negative impacts on unnamed individuals or in matters that were settled or dismissed where the individual may find themselves unable to expunge their records where it would otherwise be appropriate. These concerns and resulting recommendations are discussed in greater detail below.

I. FSI's Comments

A. Introduction & Background

CRD has several important functions. First, investors rely on CRD information, made available to them through FINRA's BrokerCheck, to assist them in deciding whether to do business with a particular financial advisor.[10] Regulators use CRD to execute regulatory oversight and, at times, to identify industry trends.[11] Broker dealers use CRD information as a basis for its hiring decisions.[12] For those reasons, information contained in CRD, if it is inaccurate or confusing, may cause regulators to misidentify trends and, important to FSI's advisor members, may directly result in advisors losing clients, new business opportunities or employment opportunities.

Financial advisors may seek to have customer dispute information removed from CRD, pursuant to FINRA Rule 2080, if the claim, allegation or information is factually impossible, clearly erroneous, false or the financial advisor "was not involved in the alleged investment related sales practice violation, forgery, theft, misappropriate or conversion of funds."[13] Thus, there are limitations on the circumstances in which expungement may be appropriate. This aligns with FINRA's philosophy that "expungement of customer dispute information is an extraordinary measure."[14]

Notably, in addition to collecting information regarding fully adjudicated customer-related matters, CRD also contains other customer dispute information, such as customer claims that have been settled. It is important to keep in the mind that every settlement is not tantamount to admission of wrongdoing. In fact, financial advisors frequently agree to settle claims as part of an overall settlement agreed to by the broker dealer they are associated with at the time of the alleged misconduct. Financial advisors also, individually, decide to settle an action, even ones they believe are without merit, to avoid the cost and expense associated with arbitration or litigation or due to the unpredictable nature of the same.

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[10] See FINRA Office of Dispute Resolution Arbitrator's Guide, at p. 72 available at http://www.finra.org/sites/default/files/arbitrators-ref-guide.pdf.
[11] *Id.*
[12] *Id.*
[13] See FINRA Rule 2080 (b)(1) (A) – (C).
[14] See Notice at p. 57.

In these cases, the financial advisor may not have engaged in any wrongdoing. This is why the need to balance investor protection and regulatory value, with fairness to advisors, becomes so important. Hence, in implementing its series of changes to the expungement to the process, FINRA should consider these financial advisors; and not only the high risk, recidivist, or other advisors who pose an inherent threat to investor protection.

B. Qualifications for Arbitrators to Appear on the Special Arbitrator Roster Should be Broadened to Include Persons Who Have Worked in the Securities Industry in a Registered Capacity

FSI is concerned that the all-public requirement for the Special Arbitrator Roster (Roster) implies that those with industry experience would somehow seek to "protect" bad actors or in some way be predisposed to grant expungement. On the contrary, we believe those with industry experience bring an important and vital perspective to the process and are particularly well-situated to understand potential risks to investors and the importance of providing them with accurate and truthful disclosure information.

As proposed, three public chairpersons chosen randomly from the Roster would decide certain straight-in expungement requests.[15] To be included on the Roster, public chairpersons must "have completed chairperson training provided by FINRA and: (1) have a law degree and are a member of a bar of at least one jurisdiction and have served as an arbitrator through award on at least one arbitration administered by an SRO in which hearings were held; or (2) have served as an arbitrator through award on at least three arbitrations administered by an SRO in which hearings were held."[16] Based on these requirements, and the random selection process, it is possible to have a panel consisting of three licensed attorneys, who are trained in expungements, but who lack any meaningful securities industry experience.[17]

While these persons may understand the importance of maintaining public records, they may not understand the securities industry. Without this understanding, it may be difficult to appreciate whether information has regulatory significance or investor protection value. FSI, therefore, suggests that industry participants who have worked as a general securities principal for a least five consecutive years, in the prior seven-year period, be eligible for inclusion on the Roster. Persons meeting those requirements would be eligible for inclusion regardless of whether they are attorneys, providing however, that they do not have any disciplinary history. While this would, in certain cases, mean that the panel would be semi-public, as noted, this person would be able to speak to, and access, the integrity of the underlying facts. Alternatively, a potential panelist could provide proof of similar qualifications relating to the industry (e.g., pre-existing experience as a practicing securities attorney).

FSI also suggests that, at least one person on each three-person panel be required to have securities industry experience either as general securities principal that meets the qualifications outlined above; or as an attorney who has the requisite five years' experience in state or federal securities regulation or as a securities regulator. This will help ensure that one person on the panel not only understands the general importance of maintaining records, but also understands the factual nuances that gave rise to the customer dispute, as well as whether the information has regulatory and investor protection value.

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[15] See Proposed Rule 13806 (b).
[16] See Proposed Rule 13806 (b)(2).
[17] *Id.*

C. Expungement Should Be Granted by a Majority as Opposed to Unanimous Panel Decision

Regardless of the makeup of the Special Arbitrator Roster, FSI believes the decision on whether to grant expungement need only be a majority decision as opposed to unanimous. This becomes even more important should FINRA continue to require the panel be all public and disallow those with industry experience to participate in the Roster. The Proposed Amendments would require the panel to provide a detailed explanation of the rationale for granting expungement.[18] We are concerned that if unanimity is mandated, expungements will not be granted even where appropriate.

We understand that various stakeholders believe the unanimity requirement is essential to ensuring the remedy remain "extraordinary." However, FSI believes the requirement of the written rationale will encourage unanimity of the decision without mandating it and will further ensure the remedy is indeed "extraordinary" as required of the panel. We believe the majority decision of the panel along with the written rationale maintains the necessary balance between investor protection and regulatory value with fairness to advisors.

D. Disclosure by Unnamed Parties or in Matters Settled or Dismissed Should Not Be Unnecessarily Cost Prohibitive or Difficult Where Expungement is Appropriate

Firms are required to report, as customer complaints, allegations of sales practice violation made in arbitration claims and civil lawsuits against financial advisors who are not named as parties in those proceedings or in matters that do not reach a hearing because they are settled or dismissed. Unfortunately, this can result in a lack of due process for the advisor as it results in a negative disclosure on their BrokerCheck record even though the advisor did not have the opportunity to participate in the arbitration to dispute the allegation. With respect to the advisor and in cases where the matter is heard, the arbitration panel is left with a one-sided presentation of the facts. Hence, any regulatory value of disclosing this information on BrokerCheck is greatly diminished.

While the Proposed Amendments allow for an unnamed person who becomes aware of the matter to agree with the firm to make the request on their behalf during the arbitration,[19] there are instances where the unnamed person may not be made aware of the matter and the Proposed Amendments would preclude the individual from intervening in the matter in order to request expungement.[20] In those cases, the unnamed individual must file the expungement request "as a new claim against the member firm at which the person was associated at the time the customer dispute arose."[21] In this case, the Special Arbitrator Roster would then hear the request and make a decision. A similar situation arises when the matter is settled or dismissed instead of going to hearing.

As a practical matter, this means the original arbitration panel, who has the most familiarity with the facts, is not able to make a decision on the request and instead, a new matter, a new panel, and a new hearing must be undertaken. This presumably also results in additional

[18] See proposed Rules 12805(c)(8)(B) and 13805(c)(9)(B).
[19] See Proposed Rule 12805(a)(2)(A).
[20] See Proposed Rule 12805(a)(2)(E)(iii)b.
[21] *Id.*

substantial costs for the individual now trying to clear their record of the allegation. As proposed, this situation eliminates much of the efficiency and cost effectiveness that are the hallmark of arbitration and which benefit both parties.

FSI suggests that FINRA continue to consider alternatives to requiring a new matter before the Roster, particularly for unnamed individuals but also in cases where the matter has been settled or dismissed. And where firms have already paid the fee in the original matter, advisors should not then be required to pay another full fee for expungement requests.

Conclusion

We are committed to constructive engagement in the regulatory process and welcome the opportunity to work with FINRA and the SEC on this and other important regulatory efforts. That said, these Proposed Amendments, previously published for comment nearly five years ago, have significantly changed and commenters were given only 21 days to analyze and comment on the changes. We encourage FINRA and the SEC to seriously consider ours and others' comments that suggest important changes and improvements to the Proposed Amendments in order to ensure advisors' disclosure information is truly accurate and useful to investors.

Thank you for considering FSI's comments. Should you have any questions, please contact me at [redacted]

Respectfully submitted,

Robin M. Traxler
Senior Vice President, Policy & Deputy General Counsel